

Q4/2013

CESEE Research Update

Foreign Research Division

Content

CEEI 2013.....	2
Olga Radzyner Award Winners 2013...3	3
OeNB-BOFIT Projections for Selected CESEE Countries.....	4
OeNB Euro Survey of Households in CESEE	4
Focus on European Economic Integration Q4/13.....	6
Call for Applications: Visiting Research Program.....	8
Upcoming and Recent Events	9
OeNB Courses at the Joint Vienna Institute	9

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The CESEE Research Update is released quarterly by the Foreign Research Division of the Oesterreichische Nationalbank (OeNB). The aim of this newsletter is to inform readers about OeNB research and analysis output on Central, Eastern and Southeastern Europe (CESEE) as well as past and forthcoming CESEE-related events.

Foreign Research Division

OeNB

Highlights of This Issue

- **Conference on European Economic Integration (CEEI) 2013** (see p. 2).
- **Olga Radzyner Award Winners 2013** (see p. 3).
- **OeNB-BOFIT Projections for Selected CESEE Countries: Recovery to Gain Traction Gradually - Downside Risks Still Prevail** (see p. 3)
- **OeNB Euro Survey of Households in CESEE** (see p. 4)
- The latest issue of the OeNB's quarterly publication "Focus on European Economic Integration" has just been released (see p. 6).
- The OeNB invites applications from external researchers for participation in a **Visiting Research Program** established by the OeNB's Economic Analysis and Research Department (see p. 8).

Conference on European Economic Integration (CEEI) 2013: "Financial Cycles and the Real Economy: Lessons for CESEE"

This year's Conference on European Economic Integration (CEEI) took place in Vienna on November 18 and 19, 2013, and dealt with "Financial Cycles and the Real Economy: Lessons for CESEE." From this perspective, the CEEI 2013 investigated the links between financial sector developments and the real economy. In particular, it examined to what extent the heterogeneous recovery paths of CESEE countries reflected both differences in the pattern of their financial cycles prior to the crisis and varying policy responses. More than 330 participants from around 35 countries followed the presentations and discussions of high-profile representatives of international organizations, central banks, academia as well as the banking and the real sector.

Against the background of improving but still heterogeneous economic developments, **OeNB Governor Nowotny** urged that financial fragmentation in Europe be reversed and a European rather than national perspective be taken in dealing with the crisis-induced policy challenges. Keynote speaker **Claudio Borio (Head of Monetary and Economic Department, BIS)** emphasized the need to re-think standard macroeconomic models that are incapable to predict severe financial distress. In particular, he proposed to replace standard output gap measures by "finance-neutral" potential output. Moreover, he argued that ill-designed policies posed a key risk for global recovery. He therefore advocated more anticyclical policies which lean more aggressively against the buildup of imbalances in the boom phase and do not ease too much during a bust. In the following panel discussion, board members of the Czech, Croatian, Polish and Slovenian central banks shared their experience with real and credit cycles as well as with macroeconomic and macroprudential policies in their respective countries.

In his dinner speech, **Jörg Asmussen (Member of the Executive Board, ECB)** contrasted positive and negative examples of how CESEE countries have been

experiencing convergence. He noted that credit-fueled domestic demand booms accompanied by rising living standards and deepening integration turned into post-crisis credit busts in which real convergence had virtually come to a halt. Against this background, he urged that we should strive for better integration and for sustainable convergence. In the ensuing discussion, he emphasized that the emerging European banking union would only work if both the Single Supervisory Mechanism and the Single Resolution Mechanism were put in place roughly at the same time as two supranational, independent institutions.

The second conference day was opened by a keynote speech by **Claudia Buch (President, Halle Institute for Economic Research)**. She started off by showing that economists not only failed to predict the current financial and economic crisis but that in fact macroeconomic forecasts have barely improved since the 1960s. She then analyzed potential reasons for this unsatisfactory development and discussed which existing and emerging model approaches address these shortcomings. She stressed, however, that only time would tell which of the new approaches would hold up to scrutiny and which would prove to be dead ends. The conference was closed by a practitioners' panel which featured high-level representatives from the European Investment Bank, from commercial and investment banks as well as large Austrian enterprises active in CESEE.

For details and presentation downloads, please visit [CEEI 2013](#).

The conference proceedings of the CEEI 2013 will be published by Edward Elgar Publishing Ltd. in the course of 2014.

Olga Radzyner Award Winners 2013

The Olga Radzyner Award has been bestowed on young economists from Central, Eastern and Southeastern Europe (CESEE) for excellent scientific work on European economic integration since the year 2000. The OeNB established this award to commemorate Olga Radzyner, who was at the vanguard of the OeNB's CESEE-related activities.

In 2013, the OeNB received 33 submissions from young CESEE economists from 15 countries. The OeNB Governing Board selected four papers for distinction with the Olga Radzyner Award, because they were considered outstanding in terms of originality, motivation and analysis as well as the use of state-of-the-art methods. The awards were conferred by Governor Ewald Nowotny on November 18, 2013, at the OeNB's Conference on European Economic Integration. The winners are (in alphabetical order):

Calin Vlad Demian (from Romania), PhD student at the Central European University in Budapest – He analyzed the gains from trade in a multi-country Ricardian model with inter-industry linkages within each country. Comparing the trade costs before and after EU enlargement, he finds that EU enlargement had a positive, trade cost-reducing effect for all Member States. These gains from trade were found to be comparatively larger for the new EU Member States in CESEE.

Biljana Jovanovic, analyst at the National Bank of the Republic of Macedonia, and **Branimir Jovanovic**, PhD student at University of Rome "Tor Vergata" (both from

FYR Macedonia) – They investigated if ease of doing business, measured by the World Bank's Doing Business indicators, matters for investment in 28 CESEE countries. Across a wide range of specifications, ease of doing business robustly proves to have a considerable positive impact on FDI from OECD countries. The impact on total investment is also positive but somewhat smaller.

Balint Menyherth (from Hungary), PhD student at the Central European University in Budapest – He studied the impact of social diversity on economic development with a view to identifying a causal relationship, based on a sample of about 1,700 historical Hungarian townships. He finds that social diversity has a sizeable and positive impact on economic development. Apparently, localities with a more diverse social structure grew faster than others because they had a broader pool of persons with specialized skills.

Peter Tóth (from Slovakia), senior economic analyst at the Ministry of Finance of the Slovak Republic – He introduces exchange rate pass-through into a partial equilibrium model that takes into account heterogeneous firms and full cost structure. Applying this model to a firm-level dataset for the Czech Republic, he finds that importing firms partially cushion the negative effects exchange rate appreciations have on their export sales by importing intermediate goods and services of greater variety and higher quality.

[Olga Radzyner Award Winners 2013](#)

OeNB-BOFIT Projections for Selected CESEE Countries: Recovery to Gain Traction Gradually - Downside Risks Still Prevail

GDP growth in the **CESEE-7 region** will remain below 1% in 2013 for the second consecutive year, influenced by a weak carryover from 2012. In the course of 2013, domestic and external demand has been gradually strengthening and will lead to firming growth dynamics over the projection horizon. The region's GDP growth rate will rise from 0.8% in 2013 to 2.3% in 2014 and 2.8% in 2015. In 2013, domestic demand will show a negative growth contribution in all countries apart from Hungary, while in 2014 and 2015, growth will increasingly be powered by the revival of domestic growth drivers, in particular private consumption and gross fixed capital formation. We expect to see an increase in both external and domestic demand over the forecast horizon. However, the stronger growth dynamics in domestic

demand imply that the growth contribution of net exports will fall to close to zero in all countries (and even turn negative in Bulgaria and Romania in 2015). The growth differential to the euro area will be 1.1 percentage points in 2013 and slightly higher thereafter (1.4 percentage points in 2014 and 1.3 percentage points in 2015). Hence, the growth differential will remain at less than half of its precrisis value, implying a fairly slow catching-up process. The risks to these projections remain tilted to the downside and stem mostly from developments in the external environment (expiration of the temporary increase in the U.S. public debt ceiling, intensification of the euro area debt crisis, intensification of political unrest in the Middle East and rising oil prices).

Due to the unexpectedly sharp slowdown of economic activity in **Russia** in the first half of 2013, we have adjusted our GDP growth forecast for the whole year to below 2%. Russian growth is seen to recover to above 3% in 2014 and 2015 in tandem with the global economic recovery. Accordingly, Russian import growth will rise slightly to 6% in 2015. Risks to the Russia forecast are also tilted to the downside on account of both domestic and international factors. A delay – or rather an interruption – of the global recovery would have a severely negative

impact on the Russian economy. Likewise, a fall in the oil price due to intensified shale gas exploitation and higher liquefied natural gas deliveries would constrain growth in Russia. Domestic risks arise from a slowdown in household incomes and state expenditure exceeding our predictions.

[Focus on European Economic Integration Q4/13](#)

OeNB Euro Survey of Households in CESEE: Euro Cash Holdings per Capita Declining

Evidence from the OeNB Euro Survey of households shows that euro cash holdings are widespread in many CESEE countries, with the percentage of respondents holding euro cash ranging from less than 10% (Poland, Hungary, Bosnia and Herzegovina and Bulgaria) to every fourth respondent (Serbia, FYR Macedonia and Albania) (see figure 1).

The Euro Survey also finds different people in different regions to hold euro cash for different reasons: whereas respondents in Central Eastern Europe do so mainly to

be able to make payments abroad, people in Southeastern Europe see euro cash mainly as a store of value. Based on this evidence, one would expect euro holdings to be higher in Southeastern Europe than in Central Eastern Europe – which is indeed confirmed by the survey evidence: Figure 1 shows the amounts of euro cash per capita extrapolated from the survey evidence for the population aged 14 years and older.

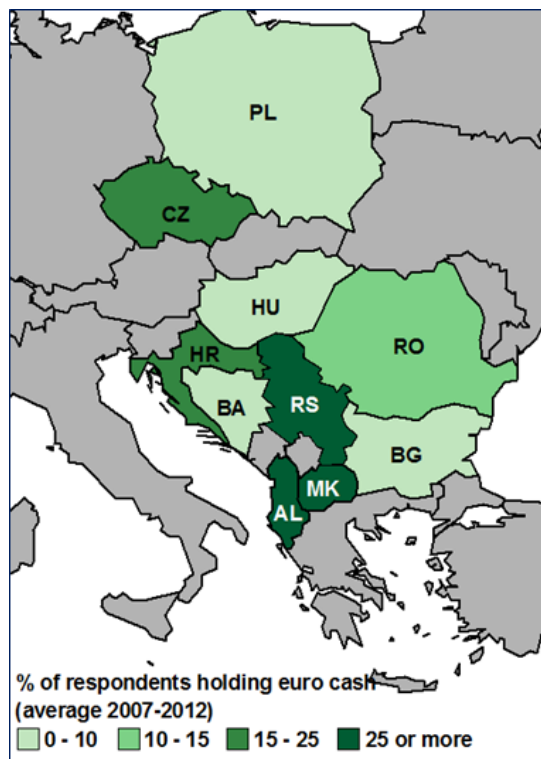
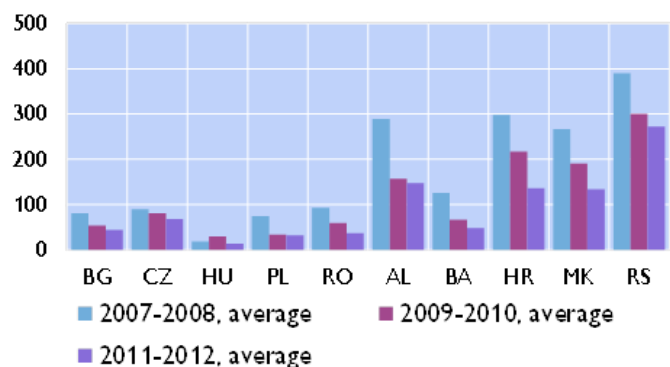


Figure 1: Dissemination of Euro Cash Holdings

Amounts of Euro Cash Holdings

EUR, per capita (projection)



Source: OeNB Euro Survey.

Note: Per capita values are extrapolated for the entire population aged 14 years and over. Currency substitution index = ratio of euro cash to euro cash plus national currency in circulation. For details see Scheiber and Stix (2009).

Figure 2: Amounts of Euro Cash Holdings by Individuals, projections for per capita cash holdings

Comparing developments since 2007, we observe euro cash holdings to have declined in all CESEE countries. At the same time, the relative importance of savings deposits over cash holdings has increased in all countries, except Hungary – this is one of the main findings of Scheiber (2013), who combined this survey evidence with aggregate monetary data with a view to analyzing the portfolio composition of an average household in terms of cash holdings and savings deposits denominated

in both domestic and foreign currency. Other findings include: The cash savings of households have tend to decline, reflecting above all a relative decline in euro cash holdings. In Southeastern European countries, euro cash holdings have, in fact, been declining in absolute values and in terms of their relative importance in households' portfolios.

References:

Scheiber, T. 2013. Section 4.5: Results from the OeNB Euro Survey of Households in Central, Eastern and South-eastern Europe. In: European Central Bank, The International Role of the Euro, 29–32.

Scheiber, T. and Stix, H. 2009. Euroization in Central, Eastern and Southeastern Europe – New Evidence On Its Extent and Some Evidence On Its Causes. OeNB Working Paper 159.

Stix, H., 2013. Why do people save in cash? Distrust, memories of banking crises, weak institutions and dollarization. *Journal of Banking and Finance*, 37(11), 4087–4106.

The OeNB Euro Survey has been conducted since fall 2007 on a semi-annual basis in ten Central, Eastern and Southeastern European countries. It gathers information on the use of the euro among households with regard to cash holdings, savings and loans and provides a picture of how households evaluate the current and future economic situation of their country as well as of the household itself. For further information on the survey and related publications please visit ceec.oenb.at.

OeNB Course “Macrofinancial Stability in CESEE” at the Joint Vienna Institute, October 13–17, 2013

On October 14–18, 2013, the OeNB's Foreign Research Division organized, together with Reiner Martin from the ECB's Financial Stability Assessment Division, its annual seminar on “Macrofinancial Stability in Central, Eastern and Southeastern Europe” at the Joint Vienna Institute (JVI).

This one-week course addressed key economic policy issues the CESEE countries are facing in a challenging domestic and global environment. The lectures and discussions cover macrofinancial stability issues that are of specific relevance to central banking. This year, a special focus was put on the interactions between the real economy and the financial sector, the role of fiscal policy and the assessment of financial stability risks. Group sessions, which are always an essential part of the course, were designed as “Troika negotiations” this year, i.e. the participants took on the role of country representatives and international authorities and were asked to negotiate an adjustment program for exemplary countries subject to macrofinancial stress.

This course attracted 30 experts and mid-level officials from central banks or ministries of finance from CESEE countries and – for the first time – CIS countries. Our participants thus came from a wide mix of countries, ranging from Albania to Tajikistan, or from Estonia to Turkey.

The seminar feedback was highly positive. 85% of the participants strongly agreed that they were satisfied with the course and that they would recommend it to others. Moreover, about 65% of the participants strongly agreed that the knowledge and information provided will add value in their jobs.

The seminar will be repeated next year, from October 13–17, 2014. Attendance is by invitation only; please address inquiries to Ms. Romana Lehner (romana.lehner@oenb.at).



Focus on European Economic Integration Q4/13

Recent Economic Developments and Outlook: Developments in Selected CESEE Countries: Economic Activity Finally Starting to Recover, compiled by Schreiner J., pp. 6-16.

[Focus on European Economic Integration Q4/13](#)

74th East Jour Fixe: Latvia Joining the Euro Area, compiled by Slacik T., Urvova J., pp. 90.

[Focus on European Economic Integration Q4/13](#)

Seminar on the IMF's Regional Economic Issues: "Faster, Higher, Stronger – Raising the Growth Potential of CESEE", compiled by Lerner C., Urvova J., pp. 92.

[Focus on European Economic Integration Q4/13](#)

18th Global Economic Lecture: Rachel Griffith – Multinational Firms, Intellectual Property and Taxation, compiled by Wörz J., Urvova J., pp. 93.

[Focus on European Economic Integration Q4/13](#)

Backé P., Feldkircher M., Slacik T., "Economic Spillovers from the Euro Area to the CESEE Region via the Financial Channel: A GVAR Approach", pp. 50-64.

In this paper we examine the spillovers of a shock to real output in the euro area to Central, Eastern and Southeastern Europe (CESEE) and its subregions Central Europe, Southeastern Europe, Russia, and the other members of the Commonwealth of Independent States (CIS). To this effect, we apply a global vector autoregressive (GVAR) model and go beyond existing work by examining the relative importance of the financial channel compared with the trade channel. Moreover, we assume that shocks spill over from the euro area to the CESEE region via the financial channel whereas financial spillovers within CESEE are negligible (except for spillovers between Russia and the other CESEE countries, which we do capture). Our results are as follows: We find spillovers transmitted via the trade channel to be larger than spillovers via the financial channel for Southeastern Europe, but smaller for Russia and the other CIS countries. For Central Europe, the two channels have a broadly similar impact. When we assess the relative importance of the two channels based on

how well they explain historical movements in the data we see that spillovers via the two channels have indeed been of equal importance for Central Europe. However, the financial channel has traditionally dominated the trade channel in Southeastern Europe, whereas the trade channel has traditionally played a stronger role for the CIS region. Overall spillovers reflecting both transmission channels are comparatively more moderate for Central Europe and Russia, while they are a bit larger for Southeastern Europe and considerably higher for the CIS region excluding Russia: The long-run effect of a +1% euro area output shock ranges from 0.3% in Central Europe and Russia to 0.7% in the other CIS countries.

JEL classification: C32, F44, E32, O54

Keywords: financial shocks, international shock transmission, GVAR, CESEE

[Focus on European Economic Integration Q4/13](#)

Beckmann, E., Moder, I., "Households' Expectations and Macroeconomic Outcomes – Evidence from the Euro Survey", pp. 65-76.

Using evidence from the OeNB Euro Survey, we show that households in Central, Eastern and Southeastern Europe (CESEE) are more optimistic about the development of their own financial situation than the development of their national economies. There are significant

cross-country differences regarding the level and volatility of expectations; however, since the onset of the financial and economic crisis, the movements of expectations have become more homogeneous within CESEE.

Households' expectations about the economy are positively correlated with subsequent GDP and consumption growth. These results indicate that data on expectations could add predictive power to forecasting models for CESEE, especially if observed at a higher frequency and released without large time lags.

JEL classification: D14, G01, D12, E21

Keywords: Expectations, survey data, Central, Eastern and Southeastern Europe

[Focus on European Economic Integration Q4/13](#)

Rautava, J., "Oil Prices, Excess Uncertainty and Trend Growth, A Forecasting Model for Russia's Economy", pp. 77-67.

The sharp contraction of Russian output in 2008–2009 and the country's recent poor growth performance came as a surprise to policymakers and analysts in Russia and elsewhere. In this paper, we examine the factors behind these developments, using a small structural error-correction (SVEC) macro model built for forecasting purposes. The estimation of the model indicates that Russia's economy is still strongly influenced by international oil prices and that there seems to be no major difference in this respect before and after the 2008–2009 crisis. However, in our linear model setup, oil prices alone cannot, for example, explain the major recession Russia faced in 2008–2009. To improve our forecasts around such particular events, we explicitly

account for increased uncertainty that is likely to have a direct impact on the real economy. Here, we estimate the impact of excess uncertainty by using exchange rate expectations. As to Russia's recent poor growth performance, the computations in this paper suggest that trend growth in Russia has halved from about 4% before 2008 to about 2% in 2013.

JEL classification: C32, E17, O13, P28, Q43

Keywords: Russian GDP, oil prices, trend growth, uncertainty, SVEC, forecasting

[Focus on European Economic Integration Q4/13](#)

Abstracts from Other CESEE-Related Publications

Eller, M., Fidrmuc, J., Fungáčová, Z. (2013). Fiscal Policy and Regional Output Volatility: Evidence from Russia. BOFIT Discussion Papers No. 13/2013.

This paper investigates the relationship between fiscal policy and output volatility in Russian regions between 2000 and 2009. System GMM estimation techniques are used to account for potential endogeneity between output volatility and fiscal developments. Our main finding is that fiscal activism, proxied by various measures of discretionary fiscal policy, contributes to output volatility and so induces macroeconomic instability at the regional level in Russia. This result corroborates previous studies using

cross-country data. To reduce business cycle fluctuations, it would be necessary to curtail pro-cyclical fiscal activism at the regional level, e.g. via fiscal rules and sound institutions of fiscal federalism.

Keywords: Output volatility, automatic stabilizers, discretionary fiscal policy, dynamic panel models, Russia

[BOFIT Discussion Papers No. 13/2013](#)

Research Visit at the OeNB's Foreign Research Division

From September 2 to November 29, 2013, Ludmila Fadejeva, senior econometrician in the Monetary Research and Forecasting Division (Monetary Policy Department) of Latvijas Banka worked at the OeNB's Foreign Research Division under the External Work Experience (EWE) framework of the European System of Central Banks (ESCB). During her working visit, she analyzed the effects of an assumed negative euro area loan supply (LS) shock on CESEE economies in cooperation with Martin Feldkircher and Thomas Reininger (both Foreign Research Division). The team developed a global VAR model that includes credit series. To isolate the LS shock from other macroeconomic shocks, they proposed a new way of identifying structural shocks by using the cross-sectional

dimension of the global model. Their main findings are as follows: First, the effect of the LS shock on total credit (and therefore on output) is more pronounced than that of an aggregate demand (AD) shock. Second, in the euro area, the response of total credit to both an AD and an LS shock is about twice as strong as the response of output. Third, the response of output and credit to both euro area LS and AD shocks is pronounced throughout the CESEE region. Finally, in relative terms, the effect on CESEE economies is about twice as strong as the impact on the euro area for both output and total credit. The research results will be published as a working paper by the OeNB and by Latvijas Banka.

Other CESEE-Related Publications

Feldkircher, M., (2013). *A Global Macro Model for Emerging Europe*. OeNB Working Paper 185, 2013.

This paper puts forward a global macro model comprising 43 countries and covering the period from Q1 1995 to Q4 2011. The author's regional focus is on CESEE and the Commonwealth of Independent States (CIS). Applying a global VAR (GVAR) model, he is able to assess the spatial propagation and the time profile of foreign shocks to the region. The author's results show that first, the region's real economy reacts nearly equally strongly to an U.S.A. output shock as it does to a corresponding euro area shock. The pivotal role of the U.S.A. in shaping the global business cycle thus seems to partially offset the region's comparably stronger trade integration with the euro area. Second, an increase in the euro area's short-term interest rate has a negative effect on output in the long run throughout the region. This effect is stronger in

CIS as well as in Southeastern Europe, while it is comparably milder in Central Europe. Third, the region is negatively affected by an oil price hike, with the exception of Russia, one of the most important oil exporters worldwide. The oil-driven economic expansion in Russia seems to spill over to other – oil-importing – economies in CIS, thereby offsetting the original drag brought about by the hike in oil prices. Finally, the author's results corroborate the strong integration of advanced economies with the global economy. By contrast, the responses in emerging Europe are found to be more diverse, and country-specifics seem to play a more important role.

[Working Paper 185](#)

Call for Applications: Visiting Research Program

The OeNB invites applications from external researchers for participation in a Visiting Research Program established by the OeNB's Economic Analysis and Research Department. The purpose of this program is to enhance cooperation with members of academic and research institutions (preferably postdoc) who work in the fields of macroeconomics, international economics or financial economics and/or pursue a regional focus on Central, Eastern and Southeastern Europe.

The OeNB offers a stimulating and professional research environment in close proximity to the policymaking process. Visiting researchers are expected to collaborate with the OeNB's research staff on a prespecified topic and to participate actively in the department's internal seminars and other research activities. They will be provided with accommodation on demand and will, as a rule, have access to the department's computer resources. Their research output may be published in one of the depart-

ment's publication outlets or as an OeNB Working Paper. Research visits should ideally last between three and six months, but timing is flexible.

Applications (in English) should include

- a curriculum vitae,
- a research proposal that motivates and clearly describes the envisaged research project,
- an indication of the period envisaged for the research visit, and
- information on previous scientific work.

Applications for 2014 should be e-mailed to eva.gehringer-wasserbauer@oenb.at by May 1, 2014.

Applicants will be notified of the jury's decision by mid-June. The following round of applications will close on November 1, 2014.

See also: [Visiting Research Program 2013](#)



Research Update Q4 2013:

Economic Analysis and Research Department of the OeNB

To find out more about OeNB economic research and analysis topics as well as past and forthcoming OeNB events ranging beyond CESEE-related research, see the next issue of the OeNB's Research Update, which is due to be released in March 2014.

http://www.oenb.at/en/presse_pub/period_pub/volkswirtschaft/newsletter/einleitung.jsp

Upcoming and Recent Events

The following events are organized by the OeNB and cover CESEE relevant topics. Please note that attendance is by invitation only. If you are interested in participating in one or more of the events, please send an e-mail to ceec@oenb.at.

Upcoming

January 27, 2014	Presentation of the EBRD Transition Report 2013 jointly with The Federal Ministry of Finance
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Recent

September 19 - 20, 2013	6th Meeting of the ECB Research Network on Competitiveness (CompNet) at the Joint Vienna Institute
October 10, 2013	Global Economy Lecture 2013 jointly organised with the WIIW. Lecture by Rachel Griffith (Institute for Fiscal Studies, London): "Multinational firms, intellectual property and taxation"
October 21, 2013	74 th East Jour Fixe "Latvia Joining the Euro Area", in cooperation with the Austrian Society for European Politics
November 18 - 19, 2013	Conference on European Economic Integration 2013 "Financial Cycles and the Real Economy: Lessons for CESEE" in Vienna

OeNB Courses at the Joint Vienna Institute (JVI)

For further details see: www.jvi.org

January 20-23, 2014	Advanced Course on Financial Stability Stress Testing for Banking Systems
May 12-16, 2014	Institutional Challenges for EU Candidate and Potential Candidate Countries on the Road to the EU and EMU
September 15-17, 2014	Cash Circulation and Payment Systems in Austria
October 13-17, 2014	Macro-Financial Stability in Central, Eastern and Southeastern Europe
October 20-24, 2014	Economic and Monetary Integration in Europe
November 17-21, 2014	Monetary and Financial Statistics Collected and Compiled by the ESCB
December 1-2, 2014	Financial Education in Central Banks: Initiatives and Activities

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